Incentive Theory

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Abstract

In this paper I examine agency theories and the impact it has on corporate life today. I find substantial support (in research and real life) the teaching itself has contributed to greed and the “agency culture” that has driven many firms to their doom.

When it comes to game theory and experiments people tend to be self-serving at different levels. Outside these applications most people are also self-interested, resourceful and maximizers (REMM) but it is not all they care about, as they want to create their own fortune without violating the social norms, unless they believe the benefits are great enough.

Despite being the most used incentive, external incentives are unreliable as they often fail to satisfy core psychological needs (autonomy, competence and relatedness). A person’s well-being is depending on the fulfillment of the three core psychological needs which in financial incentives are translated into core financial beliefs (financial self-efficacy, financial autonomy and financial relatedness).

When looking at history and the present we are able to find angel agents and principals with great personal traits, who are great at using internal incentives in their leadership and creation of culture, in which the put the agents first, without tempting the agent with huge benefits packages.

In addition external CSR can also be considered in motivating the agents through external prestige and Employee-company identification (E-C identification).
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Introduction

One experience in class I will never forget was in one of my late night classes in HD “organization and management”. It was in the course management, and we had a guest teacher from a big company. One of the first things he did was asking the question “when do firms have the best employees in the world?” Thinking about the question I got an image of a heroic employee/manager who loved his work, and not the money or other selfish incentives. Interrupted in my ideal thoughts the guest teacher answered “when the employees have the same goals as the company”. An answer none of us could argue with and an answer that seemed perfectly logical. Also a question that has been nagging management and theorists for more than a century now. How do firms (principal) align agent’s goals with the company’s, most effectively?

Problem/issues addressed

In this term paper I will investigate, assess and review what the theories, experiments and research of agency imply and what impact they have in real life. Take examples from real life and use them as questions and arguments.

Are external incentives and self-interest in corporate life always the most dominant force? As it seems in agency theories, or can the firm align the employee’s goals with its own, through other measures? Are there companies that are known for motivating employees in a different way other than using incentives?

The literatures I will draw upon are mostly papers from the library and other sources from the Internet. In addition I will use relevant books from the class and library.

Outline

Abstract

Introduction

Problem/issues addressed

Implication of different Theories

Analysis and Review
Summary and Conclusion

Agency Theory

For many years agency theory has shown to be a topic which cannot be ignored in firms. It refers to a situation where one individual (agent) acts on behalf of another (principal) and is expected to reach the principal’s goals (Milgrom & Roberts, 1992: 170). Agency problems are basically an economic reference for problems of motivation. A principal/agent relationship or agency relationship exists when one party (agent) is hired to do work that affect the payoff to the principal.

Firms today employ dozens, hundreds and even thousands of individuals. This growth in firm size creates new challenges. When a firm hires an agent, the firm must consider how it can motivate the agent to perform in the best interest of the company. On top of that the firm needs to coordinate the agent’s action with others in order to achieve giving goals.

The agency framework can be applied in many situations. Inside the company where the CEO and employees can be agents to the shareholders. Outside the firm where suppliers and many others take on the agency role.

Deciding which one is the principal and which one is the agent is very situational and often the principal can also act like an agent, which also has been debated a lot in recent history. Consider the CEO delegating work to the employee making him the agent and the CEO the principal. On the other hand the employee is also depending upon the manager making the right strategic decisions, protecting their job, time and effort they have invested in the company, reversing the roles (Blair, 2000: 67).

Naturally the principal wants to maximize the payoff it gets from the effort of the agent and the difference between the value it gets from the agent and any payment he or she makes to the agent. Agency problems can apparently arise under two conditions: (1) The objectives of the principal and the agent are not the same, and (2) the action of the agent or the information the agent possesses are hard to observe.

As mentioned many theories imply the agent values any direct payment from the principal and may receive other indirect benefits, such as promotion in the organization from the effort he or she makes on the job. It seems likely that the agent may assess less value in
the agency relationship, if the task he or she gets is difficult or if the payment from the principal is risky. (Besanko, David. 2010: 73-74).

**Historic Scandals, Greed and Hubris**

The press today is filled with greedy and hubris CEOs that are driven by the external incentives they get, and give little attention and consideration to the shareholders. Perfectly displayed by the many scandals in the early twenty-first-century. At the moment in Denmark we all know about the overpaid retirement benefit plan for certain key workers in the partly government owned company Dong-Energy, where middle managers have been able to pressurize the company for more and more lucrative incentives. Something that has outraged the population in Denmark (http://www.dr.dk/Nyheder/Penge/2012/03/15/143825.htm).

In the big international companies shareholders have been deadly wounded by the managers in Enron, Tyco, Worldcom, Parmalat, Hollinger, and elsewhere. In Hollinger International Richard Perle, a member of the firm’s board of directors signed a document without the authority of Hollinger's board that committed Hollinger to invest 25 million dollars in his private venture capital Trireme. But the self-dealing transaction did not make CEO Conrad Black take any action other the writing an internal memo stating “As I suspected, there is a good deal of nest-feathering being conducted by Richard which I don't object to other than that there was some attempt to disguise it behind a good deal of dissembling and obfuscation. I think they have done a good job rummaging all this together, but they should treat us as insiders with our hands cupped as the money flows down, and not as outsiders pouring in the money,” (Labaton, S: 2004).

In a report made by an investigating committee created by the board it was concluded that Conrad Black had run a "corporate kleptocracy" to his own benefit, and that Mr. Perle "repeatedly breached his fiduciary responsibilities" as a member of the board's executive committee, in authorizing suspicious deals to meet his own and Lord Black’s greed. Hollinger had made a bad investment in a partnership run by Mr. Perle (Norris, F: 2004).

As illustrated above the concept of greed has been universally present in the press for as long as we can remember. Therefore it would be reasonable taking a deeper look at the concept managerial greed. Despite the massive publicity in the media, the concept of greed has not been the focus of scientific study in the management field in any useful way. A possible reason for the insufficient studies may be the blurred distinction between greed and
wealth-maximizing self-interest, a fundamental assumption about rational managers, where the students at business schools and other economic educations are more likely to act “greedy” in a “dictator game”. The documents of Wang and Murnighan suggest a positive relationship between economics education and feelings toward greed, and that it is likely that peoples´ understanding of greed and their readiness to engage and vindicate greedy actions are changeable. In the dictator game where students were asked to divide 10 dollars between themselves and another person, the economic students were more likely to keep most of the money to themselves than the education students (Wang & Murnighan, 2009). In addition it may also be difficult to distinct between greed and hubris, or “exaggerated pride of self-confidence” where (Hayward and Hambrick, 1997) study in explaining the premiums paid for large acquisitions as evidence of CEO hubris, manifested the CEO greed as exaggerated pride or self-confidence. In the end the exaggerated pride stemming from the hubris would have significant effect on the price paid in an acquisition (Hayward and Hambrick, 1997).

According to Adam Smith (1937) individuals’ self-interest leads them to the most advantageous employment in exchange for their human capital, and such contracts will not only benefit the self-interest of the individual, but also the greater good of the society. In other words he believes that everybody should be self-interested. In applying it in corporate setting, the greater good occurs when marginal increases in returns to shareholders are balanced with increases in executive salary. The manager’s self-interested wealth maximization will then only be the cost of the extraordinary human capital that in turn is the source of added shareholder value (unlike greed). Therefore high incentives to CEOs are fair, if the CEO’s human capital social competences result in higher firm performance, and when marginal increases in CEO compensation can be traced back to similar increases in firm performance. However deciding what is greedy and self-interested can sometimes be difficult (http://www.age-of-the-sage.org/philosophy/wealth_nations.html).

Greed is pure and extreme self-serving where the CEO is overcompensated for the output produced. Greedy managers have little or no concern for the firm performance or shareholder wealth. By definition greed is an exaggerated lust for goods, wealth or objects or abstract value with the purpose of keeping if for one’s self, way beyond the dictates of basic comfort and survival (http://en.wikipedia.org/wiki/Greed). (Haynes, Katalin Takacs; Campbell, Joanna Tochman and Hitt, Michael A; 2010) have examined what effects CEO greed and hubris have on firm outcomes, where they have tested the following hypotheses:
Hypothesis 1: Greed has a negative effect on firm performance.
Hypothesis 2: Hubris has a positive effect on firm risk.
Hypothesis 3a: The outside director ratio negatively moderates the CEO greed-firm performance relationship.
Hypothesis 3b: The outside director ratio negatively moderates the CEO hubris-firm risk relationship.
Hypothesis 4a: The proportion of firm shares held by outside directors negatively moderates the relationship between CEO greed and firm performance.
Hypothesis 4b: The proportion of firm shares held by outside directors negatively moderates the relationship between CEO hubris and firm risk.

Not surprisingly the model provided support for hypothesis 1 where CEO greed would have a negative effect on firm performance. Hypothesis 2 where hubris has a positive effect on firm risk also found statistic support as well as hypothesis 3a which claimed that outside director ratio negatively moderates the CEO greed-firm performance relationship. Hypothesis 4b where the proportion of firm shares held by outside directors negatively moderates the relationship between CEO hubris and firm risk did not receive support, but the coefficient of the interaction of CEO greed and outsider stock holdings in hypothesis 4a, in which the outside director ratio negatively moderates the CEO hubris-firm risk relationship received support.

Regarding hubris the shareholders can rely on outside directors to help minimizing the probability that the company will decide to take too risky strategic decisions due to CEO hubris, but outside directors’ involvement/ownership in the firm seems to have no effect on the hubris-firm risk relationship. The reason for this may be that the outside board members do not have the same concern for rises in firm-specific risk due to financial reasons and the fact they are able to sufficiently diversify their financial portfolios. The big implication of the study is the new light, operationalization and development of the term greed, and according to the authors they have created a new line of inquiry in the investigation in CEO compensation. Furthermore it has been proved that not only is greed independent of hubris, but each of them having different and important effects on outcomes. So with the new findings the importance of a powerful board has become more significant and vital when having a greedy CEO (Katalin Haynes, Joanna Campbell and Michael A. Hitt 2010 page 5-6).
So after defining greed and hubris, displaying recent scandals and worst case scenarios in agency theory, the next step is to look at the reactions agency theory has led to.

**Agency Framing**

After the birth of agency theory there have been many mixed reactions from the business ethicist. For example, Margaret Blair (1995) believes that firms are becoming too obsessed with satisfying their shareholders, that they forget their moral obligations to other important stakeholder groups, such as employees. In her opinion, employees make specialized investment with the same risk level as the shareholders and thus should be treated with just as much attention. Like before consider again the employee who devotes many years of his life to the company instead of moving on to other firms. He devotes himself for more job security and more external incentives, and when rewarding employees for “firm-specific human capital investment” the firm avoids hold-up situations and are able to retain the wealth created by the “permanent” employees. All the stakeholders who make specialized investments in the company in order to increase the total wealth of the company do it with an “expectation” of getting something in return.

Blair’s biggest fear is that treating firms as a bundle of resources belonging to the shareholders undermines the expectations of all the other important stakeholders. In the worst case employees may be reluctant to do an extra effort or even less, as they see themselves as merely subcontractors, and not employees. So according to Blair the most successful firms in the future will be those who are able to nurture their human capital best (Blair, 1995).

Blair is clearly downplaying the importance of the shareholders and thus the responsibility towards them. History has shown that many agents have taken the downplayed importance too literally in the years after this article. But nonetheless she has an important point as the employees are the ones creating the value and success in the firm. The successful Richard Branson is also known for his pecking order in terms of importance as employees or associates first, customers second and shareholders third (Finkle, 2011: 118).

In addition to Blair many other business ethnics even deny that managers should be seen as “agents” of the shareholders in the theoretical term which is why they do not consider recent scandals to create need for more attention to the agency risks that lie in the shareholder-manager relation. Some have even gone so far in blaming agency theory and the teaching of agency theory in business schools for the corrupted corporate culture that caused
the scandals. Where (Wang & Murnighan, 2009) study has allude to more careful economic
education, Sumantra Ghoshal has taken the next step claiming all the “economic”
assumptions that rein in the management theories about managers being highly self-
interested, rational and maximizers (Homo Economicus) are creating a paradigm of managers
that cannot be trusted. She argues that unlike physical science where a theory that is wrong
can easily be corrected and is being preserved for discovery by someone else, the
management theory on the contrary will change the behaviors of managers and make them
act according to the theory and prejudices, if it gains enough support. For example a theory
that assumes people might behave opportunistically and simply draws its conclusions for
managing people on this particular assumption can endorse opportunistic managerial
behavior. Despite being the truth to begin with she implies that managers who are both
subjects and consumers adapt their behavior to “live up” to the doctrine (Ghoshal, S. 2005).
The response to this objection would be that the economic model of rationality says no such
thing. Utility is defined with respect to the preference of the agent and the preference can not
only be egoistic but also altruistic. However, the used words in agency theory like self-
interest, opportunism and moral hazards have a certain flavor of egoism. In addition one can
search a lot before finding a principal-agent relationship where altruistic are ascribed to a
party (Heat, Joseph 2009: 500).

Now the whole definition of agency theory mentioned before is an approach that
contains a game theory application in certain situations. Naturally one cannot exclude the
agent to behave purely opportunist, when given an instruction by the principal, nor can it be
assumed that the agent has no morale or loyalty. But it is the application of game theory and
the economic model that creates a lot of debate. This is due to the big assumption in game
theory where the players are being seen as rational and only want to maximize their payment
in order to win. This also leads to the most widespread and loudest objection, self-interest!
(Heat, Joseph 2009: 499).

**Self-Interest**

Ironically the question now is whether agency theory is the problem or the solution
(Heat, Joseph 2009: 498)? As just stated one of the widespread and immediate objections to
agency theory is the “self-interest”. Ethicists like Sumantra Ghoshal etc. think that agency
theorists assume individuals are self-interested or that they only care about their own needs
and do not have altruistic motives. In addition one does not have to search a lot before finding
an article/theory containing all the moral hazards managers should be aware of. Game theorists Milgrom, P, & Roberts, J. (1992) dedicate a whole chapter to agency theory and the moral hazards. In this chapter they define moral hazards in economics as any behavior under a certain contract that is insufficient, which creates different interests of the contracting parties and only keep existing as one party to the contract cannot tell for sure whether the other one is honoring his part of the deal, something that arises a lot in the principal-agent relationship. Among other examples they use the saving and loans crisis in the US as a problem of moral hazards, where there is a difference in the interests between owners of S&L and the federal insurance company. The problem is pretty simple, as owners will reap the profit from risky investments, and the insurance company will have to cover the costs of failures. The agency is unable to monitor and control S&L, that led the S&L management to make risky investments and even to engage in fraud, which turned out to be quite cost full to the taxpayers.

The whole chapter is full of examples of different environments of opportunistic behavior, moral hazards and various ways to control moral hazard problems. In ways like explicit monitoring, which can reduce the information problem that is a fundamental problem of the moral hazard, where one party has better/more information than the other. External incentives being paid for output performance when input cannot be measured, a bond that is fortified if the agent is caught cheating several times and will thereafter be paid to senior managers (Milgrom, P, & Roberts, J. 1992: 195).

In the chapter of Milgrom & Roberts there is no saying that agents always need to be controlled, monitored and require special contracts as they will behave opportunistically otherwise. However, the whole framing of the managers and the employees imply this. All this fear creates the classical image of game players whose only wish is to maximize their incentives. Furthermore it supports the accusations of Ghoshal and our question whether or not human natures of self-interest and external incentives in corporate life are always the most dominant force! Milgrom & Roberts are all about moral hazards, external incentives and monitoring, where internal incentives or motives like loyalty and commitment to the firm, love for the work and place are not discussed at all, thus making them superficial and the worst assumption of human nature more vivid in agency theory.
So the next obvious step would be to investigate whether or not “rational behavior” really is the most dominant and natural one when it comes to the behavior of the agents, and which influence the environment has.

**Self-Serving**

In reviewing studies created by themselves and coauthors Linda Babcock and George Loewenstein have been able to document a “self-serving” bias when judging fairness and illustrate it as a significant reason for deadlock in negotiations (Linda Babcock and George Loewenstein, 1997).

Economists and game theorists like Milgrom tend to blame incomplete information on delays in settlement. The two parties possess private information about factors as their alternatives to negotiated agreements and costs to delay, making the parties to be mutually uncertain about the other side’s reservation value. Uncertainty creates deadlocks as bargainers spend costly delays to indicate to the other party information about their own reservation value. (Cramton, Peter, 1992) gives a nice example in his study about strategic delay in bargaining with two-sided uncertainty, where we consider the negotiation of a seller and a buyer of a price of a house in a small market with few alternatives. Each party knows his own valuation of the house, but can only guess what the other party’s valuation is. Thus learning and therefore delay must occur before they can reach an agreement (Cramton, Peter, 1992: 205).

However, the uncertainty, incomplete information and deadlocks in negotiations have been difficult to test as satisfactory measures of uncertainty are hard to find.

In the paper by Linda Babcock and George Loewenstein there are three important evidences of the “self-serving” bias which are:

- the bias causes deadlocks;
- It is likely one can reduce deadlocks by debiasing bargainers
- The bias is a result from selective evaluation of information.

To be more practical we can illustrate the evidences with the example of the well-known bargaining framework, the so-called “shrinking pie” game, where the proposer is
introduced to a sum of money and asked to divide the sum with the responder. In the case where the respondent rejects the offer, the amount to be divided shrinks, then the players switch roles and the game continues either until an offer is accepted or until a specified number of rounds has been played. In this game, it was likely that the responder would reject a skewed offer and then propose a counteroffer that would give the responder less than the offer he just rejected but more equitable as the other side’s amount had been reduced by even more. In one investigation of this game (Weg, Eythan; Rapoport, Amnon, and Felsenthal, Dan S; 1990) discovered when the pie shrank at the same rate for both individuals, the rejection rate was merely 12 percent in the first round, but when the pie shrank at different rates for each party, the rejection rate was suddenly 57 percent in the first round, supporting the self-serving bias, it is likely participants whose pie shrank relatively slowly saw this as justification for demanding a large piece of the pie, but participants whose pie shrank quickly rejected the rate of pie-shrinkage as a criterion for allocating the pie. So not surprisingly people tend to be self-serving when it comes to games and similar tests, as seen now both in the test of the economic students and in the pie-shrinking game (Babcock, Loewenstein 1997, 13-14).

Most of the study of Babcock and Lowenstein are conducted from test/games where one can suspect the result not to be credible enough. So therefore it would be reasonable to take a look at a paper that does not make its implications from games.

**Polite Self-Interest**

According to Jensen and Meckling (1994) regarding human behavior there are five alternative models that are commonly used. They are:

- Resourceful Evaluative, Maximizing Model (REMM)
- Economic (Money maximizing) Model.
- Psychological (Hierarchy of needs) model.
- Sociological (Social Victim) Model.
- Political (Perfect agent model).

The first model REMM is a new term but not a new concept. It is the product of over 200 years of research and discussion in economics, philosophy and other social science. It is also the most dominant model of all the others in Jensen’s and Meckling’s paper, thus I will
only focus on this model. The explanatory power of REMM contains the best of all the other models. While all the other alternative models capture important aspects of the human behaviour, they fail in other aspects and turn out to be insufficient. From the agency view and the economic model, REMM believe that most people are self-interested, resourceful, maximizers, but most importantly it rejects the prejudiced about only caring about wealth or money income accused by (Ghoshal, 2005). From the psychological model, REMM believe that income elasticity of demand for material goods has specific regularities all over the world. However, it does not deny that people have “needs”, but the need for food for example does not need to be 100% satisfied before moving on to the next need.

From the sociological model, REMM takes on the assumption that “society” punishes people for violation of social norms, ending up affecting behavior; but it also believes that individuals will disregards the unwritten rules if the benefits are great enough. This is also what happens when social changes take place.

In the political model REMM welcome the assumption that people have the capacity for altruism. Importantly for the REMM model they care about others and take their interests into consideration while creating and maximizing their own welfare. Still REMM rejects that individuals are perfect agents seeking to service the “public good” instead of his own demands.

So in the article there is one common message: Whether you are politician, academic, manager, professional, factory worker or philanthropist, people are resourceful, evaluative maximizers. They seek to utilize the opportunities the environment introduces them to, and they want to loosen the constraints that stop them from doing what they desire to do. Their only interest is not just money, but almost everything-honor, respect, love, power and the welfare of others (Michael Jensen and William H. Meckling, 1994: 33-35).

In continuation of “nature of the man” Michael C. Jensen has also written an article called “Self-interest, altruism, incentives & agency theory”. In this article he zooms further in on the agency theory and the incentives, where many scholars, policy makers, business people and religious leaders fear and are suspicious of incentives and self-interest and are often reluctant to making use of incentives to motivate the agent.

However, in this article he argues that purposeful actions can be seen as anything other than responses to incentives. He believes that money is not always the best way to motivate,
but because external incentives are so strong, and because it sometimes can be difficult to define the proper performance measure, external incentives are often dominating the others. But where external incentives are required, they are needed because people are motivated by other things than money, as money is a claim on all resources (purchasing power). Incentives will always be there whether we like it or not and in every situation people have real choices. This is the truth in every organization as well in nature. So according to him the issue is not whether the principal wants to use incentives or not, but which incentives to endorse and which to disregard.

Furthermore the term self-interest does not mean that people have no altruistic motives. And altruism, which is the concern for the well-being of others, does not create a perfect agent who obeys the command of others. So according to Michael C. Jensen the agency problems cannot be solved by appealing and installing more altruism in people (even if possible).

It seems that he is convinced that external incentives are needed in the corporate life and a world without external incentives is inconceivable (Michael C. Jensen, 1994).

However, if the external incentives are so important, why have they caused so many scandals and miserably failed to motivate the agents in the desired way?

The Failure of External Incentives and Core Psychological Needs (Stone, Bryant & Wier, 2010) have examined the unreliability of financial incentives where they extend the self-determination theory (SDT) to explain why financial incentives sometimes fail as motivators, and have several hypotheses concerning core financial beliefs. SDT is a macro-theory of human motivation that tries to explain human well-being, human adaptation and productivity. Trying to explain the effects of external incentives, SDT has one important assumption and one prediction. (http://www.selfdeterminationtheory.org/theory) (Stone, Bryant & Wier, 2010: 107)

- **Assumption: Modern people have three core psychological needs: autonomy, competence and relatedness.**

  Competence refers to a belief that a person has effective influence on meaningful outcomes. Autonomy contains a behavior with a sense of volition, choice and SDT; it does
not have anything to do with independence, as people can choose to depend on others, still acting autonomously. Relatedness is about creating satisfying and supportive social relationships.

- **Prediction: A person’s level of happiness is partially a function of the extent to which their social environment endorses the accomplishment of, and their values and motivations are congruent with, the three core psychological needs.**

The prediction sounds a bit puzzling so to elaborate more on that we can illustrate the point with work environments that facilitate the development of autonomy and competence and also include warm relationships contributing to fulfilling core psychological needs. In addition people may choose actions that are towards or away from the fulfillment of their core psychological needs. For example, people may be obsessed with pursuing fame, wealth or social position; however, evidence indicates that these goals generally fail to satisfy core psychological needs. Besides religious believes in Buddhism, scientific research on the value on materialism has resulted in clear and consisting findings. People who are obsessed with materialistic values have lower psychological health and personal well-being. In research containing wealthy to poor, from teenagers to elderly, and from South Koreans to Australians, these findings have been documented.

This is an important empirical observation, which leads to:

- **Empirical Regularity: Materialistic financial values have a negative effect on happiness.**

Substantial research and theory suggest that individuals are highly motivated in satisfying the three core physiological needs, and also the needs for safety and security (Kasser, 2002: 22-25).

Stone, Bryant and Wires adaption and application of SDT to financial incentives has lead to three core financial need beliefs namely: financial self-efficacy (The belief that one is capable of successfully managing the financial events in one’s life), financial autonomy (The belief that one’s financial decisions are self-imposed choices that reflect one’s interests and beliefs) and financial relatedness (financial resources can support communities and others can be trusted in helping one in financial problems) (Stone, Bryant & Wier, 2010: 108-109; 124-125 ). These beliefs have lead to empirical research where 5 hypotheses were made.
In the tests of these hypotheses financial beliefs and values that according to SDT fulfill core psychological needs positively foresaw hedonic utility (satisfaction with life) e.g. happiness. On the contrary financial materialism, which SDT assumes does not fulfill a core psychological need, either negatively predicted or did not correlate with hedonic utility.

According to the authors financial incentives may fail to motivate for three reasons. First financial need beliefs and financial values are different in both type and strength. Second some persons may have tendencies to not sufficiently value financial rewards to compel acting to obtain them, and third financial materialism values generally do not satisfy core human psychological needs and have higher within-individual variance, which makes them a less reliable motivator than financial altruism. (Stone, Bryant & Wier, 2010: 120-122).

So if the principal can satisfy the three core psychological needs through the right incentives, he will most likely have a satisfied and committed employee with the same goals.

As we know by now many agency theories imply agents are mostly self-serving only care about their own wealth-fare at the end of the day.

But sometimes it may be the opposite way, which we see in this story where the agent is more motivated than the owner to do what is best for the company and its stakeholders. This does not mean that there cannot be an agency problem, but the story simply supports the fact that even the roles can be blurred and reversed as mentioned in the definition of agency theory.

**Angel Agent**

The following example is extraordinary with a so called “angel agent” landing at the Renault car company in the early 1950s. His name was Pierre Lefaucheuxs, and he had a clear vision from the very beginning where he would create a pioneer low-cost mass production capability for France and invent a car for the French public they could afford.

But the profits generated by Renault were profits the French government wanted and needed, thus creating a tension.

So over the next ten years Lefaucheuxs was able to keep the profits from the French government and displayed all the attributes of a thoughtful agent when making long-term
investment in capabilities, product lines etc. He was able to motivate the employees through a corporate culture of strong values and “camaraderie”. According to Lefaucheuxs a corporate spirit in which the workers felt part of something of economic and economic importance. The corporate spirit is something that likely has satisfied the three core psychological needs displayed earlier, in the failure of external incentives, especially relatedness.

Something that makes the story/theory so different from the other theories discussed is the unselfishness exhibited by Lefaucheuxs. Indeed there were socioeconomic and ownership contexts that may have contributed to the courage’s behavior from Lefaucheuxs, like the concern in the society to build a new society after the Second World War, and the stingy and exacting owners who invited resistance. But the core driver in the leadership Lefaucheuxs showed was mainly because of the personal characteristics.

His need for autonomy and competence was seen in his desire to improve the social and economic situations in France. Not only was he financially independent similar to the financial autonomy in SDT theory, but the fact that he had witnessed his father living the empty rich life was the reason why he cared little about money and decided to work to improve the lives of others, supporting the SDT relatedness!

The big message of this story to all principals and agents is not on aligning goals through the right incentives like according to Michael C. Jensen, but rather selecting the right principals and agents who have a long term interest in the organization. Unlike CEOs in today’s scandals, Lefaucheux did not use the asymmetric information to his own benefit, as Milgrom would fear, but rather ensuring the company’s future and ensuring the welfare of the employees.

Finding the right agent who possesses the same strengths as Lefaucheuxs like independence, conviction and courage may seem quite impossible as we seem to live in a time with more rotten apples than juicy ones. However, if finding an “angel agent” is successful, little focus on incentives are needed, and performance will most likely benefit from it (Miller, Sardais 2011).

**Angel Principal and Enron**

So now that we have looked at an “angel agent” is there any “agent principals” endorsing “angel agents”. Birds of a feather flock together, meaning “angel principals”,
would make it easier for people to value non-material things and make it easier to satisfy their three core psychological needs discussed before. Leaders can have a significant influence on a company’s culture where Schein distinguish leadership from management and administration in changes and creation of culture (Schein, 1992: 11).

If we look at today’s companies we do not have to look far before finding an independent and “wily entrepreneur” with some of the same attributes Lefaucheux had. Sir Richard Branson has over time build a billion dollar company consisting of several entrepreneurial endeavors since he was young. Like Lefaucheux Branson’s background has made him the man he is today and given him the personality traits necessary for his success. An interesting story in his upbringing is about his mother Eve always trying to challenge her kids in order to improve their growth as well as development and confidence. When Branson was only four years old his mother would drop him off at a remote location in a field and demand him to find his way back home! According to Branson “I remember that my parents continually set challenges for us. My mother was determined to make us independent” (Finkle 2011, page 110).

One of the attitudes that made Branson so hard working and motivated was his belief in making your work and hobby the same. His pleasure and commitment in doing many different things made him successful for so many years.

What makes him an “angel principal” is his talent in inspiring loyalty in his agents. He believes in his people and has respect for their ideas, also something he was taught in his childhood by his mother. The success of Virgin is highly related to the personality of Branson.

“Some of the key characteristics that described Branson included: self- motivator, aggressive, risk-taker, financially organized, excellent negotiator, creative, flexible, very competitive, proactive, hardworking, and charismatic. Branson always networked with talented and important people” (Finkle, 2011: 117).

Another interesting similarity between Lefaucheux and Branson is their priority in creating a strong corporate culture. Like Lefaucheux, Branson also wants to make the employees feel they are part of something important, and create a close family like organization. He is known for placing his employees or associates first, customers second and
shareholders third. The atmosphere in Branson’s companies is promoting casualness and fun. He wants the employees to feel there are doing their hobby and not their “job”.

The fact that he does not believe in high salaries/bonuses and exhibit loyalty and trust in delegating responsibility of entirely new businesses to his employees is a great way of downplaying the hierarchical structure and the power Branson has, concerning the power to punish and reward. In doing this he also avoids the “agency culture” that happen to Enron, where the incentives created a strong “agency culture” which is a type of culture where members repeatedly solve the agency problem with agency reasoning so that agency-reasoning becomes instilled in their values. Many of the employees of Enron were the best graduates of American MBÁ programs, highly competent technically and organizationally, but indeed may have transferred the agency-reasoning from the MBA to Enron, as postulated by (Ghoshal, S. 2005) and (Wang & Murnighan, 2009) etc. In addition, prior to the financial crisis salaries benefits packages of 1 million dollars a year were not unusual and luxuries were expected in flavor of greed and financial materialism (Kulik, B. W. 2005).

**External Corporate Social Responsibility**

Something Branson, Bill Gates etc. always have been known for, is the art of giving, in other words their Corporate Social Responsibility (CSR). Therefore it would make sense looking at what impacts CSR has on agency theory.

Companies today are becoming more and more aware of the social responsibility. In several studies concerning corporate associations and CSR the importance towards customer satisfaction and positive customer evaluations has been demonstrated. In addition to this the company performing well in CA (Corporate associations) and CSR will most likely improve the customers’ attitudes towards new products (Brown and Dacin, 1997).

According to (Kim, Lee, 2010) the external CSR can increase the employee-company identification. The identification can be formed in two ways: (a) through self-evaluation the agent can identify himself with the company if its attributes are attractive, and (b) the identification can also be established if the outsiders have a positive perception of the company thereby making the agent feel pride in his affiliation with the firm, which in turn enhances his identification with it.
Where studies investigating the connection between CSR actions and commitment have tended to focus on affective commitment defined as “an emotional attachment to, identification with, and involvement in the organization” therefore being the definition in this paper (Allen and Meyer, 1990: 21).

The identification with the firm will lead to commitment to the company. But the CSR associations do not directly influence E-C identification, but more through perceived external prestige (PEP), thereby making PEP the real source to employee/agent commitment.

So based on this implication, it is argued that external CSR performance can be another useful tool for the principal to maintain a positive relationship with the agent (Kim, Lee, 2010).

**Summary and Conclusion**

Each agency theory has its opinion/frame concerning the principal-agent relationship. On one side there are those who believe the agency theory is a tool for choosing external incentives, avoiding moral hazards, monitoring and controlling opportunistic behavior. On the other side there are those who do not endorse agency theory and have taken the next step in blaming the whole agency teaching for creating greedy agents who create an agency culture with little business ethics training. When looking at research and real life examples, it seems agency teaching has inspired the wrong way as most theories handle worst case scenarios, creating the doctrine. They do not say all agents are selfish and with no moral, but imply indirectly.

Furthermore theories also support that many people are self-interested, resourceful and maximizers. But luckily it is not everything most people care about. They take the interests of others into consideration while making their own fortune.

External incentives endorse financial materialism making them unreliable as financial materialism fail to satisfy core psychological needs. The success stories from Renault and Branson support this, and the Enron case is a real life example of what an agency culture can do.

The external CSR is also something firms can use in their E-C identification and making a positive relationship with the employee with same goals.
In future research theorists in agency theory should focus on restoring the damaging agency framing and create more ethics approaches that tackle agency problems and scandals head on. It could be through future research in management teams that are more diverse in age, sexuality, ethnically, church-going members etc. This could have an impact on future scandals like those involving Enron. Further (Conroy and Emerson, 2004) survey in “Religiosity as a Predictor of Ethical Awareness among Students” is concluded with “our findings suggest that the best way to improve ethical attitudes of college students would be to promote active participation in their religion of choice” (Conroy and Emerson, 2004: 391). It is also likely corporate life and business classes need to give more attention to “positive” theories and heroes like Lefaucheux and Branson in order avoid and destroy agency culture and the misery that follows.
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